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IFRS 15

Beware of changes to your top line and KPIs!

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Reinhard Klemmer
Head of Accounting Advisory Services.
KPMG in Singapore

Business unit heads could be surprised by the real impact of the new revenue standard

Traditionally, when accounting rules change, business unit heads leave it to the Finance team to worry about the technicalities and carry on with business as usual.

But that's not the case for the new rules on revenue recognition, which come into effect in a matter of months. IFRS 15 will have *real* impacts that businesses will feel in *real* ways – for their top line and KPIs.

Therefore, the business unit heads I've been speaking to have been very surprised to find out just how different their actual results are going to be from their budgeted figures!

Changes to your top line and KPIs

The new standard has far-reaching effects on how revenue from different contracts is recognised. The timing and amount of revenue that can be shown in each accounting period is likely to change. If it does, then performance against KPIs will also change.

Some contracts, for example, require set-up activities for which payment is made up-front. In the past, that cash might have been taken straight to revenue. Under IFRS 15, if those set-up activities don't transfer some separate goods or services to the customer, the cash needs to be spread over the contract's life.

Margins may also change. For example, profit for contracts that include design and production activities may have been recognised at a single, blended margin for the whole contract. Under IFRS 15, if these activities are distinct, the margin for each will need to reflect the revenue and costs applicable to each activity.

Broader impacts

There will also be changes for contracts with customers that have extended warranties or rebate schemes.

If you have long-term engineering or construction contracts and are currently recording revenue over time, I strongly suggest that you check whether you have an enforceable right to payment for your performance to date. If not, you're likely to need to record your revenue at a point in time rather than over time – most likely only once the contract is completed.

And the changes will have some very direct effects for people in the workforce – e.g. sales representatives with revenue targets on which their remuneration and bonuses may depend. They could discover that they miss their targets through no fault of their own, if those targets have not been adjusted for the new revenue rules.

So if you are happily preparing your budgets and projections for next year without knowing what effect IFRS 15 will have – you could be in for a nasty shock when you discover that your budget is out of kilter with the new reality.

Communicate!

Strong communication and co-ordination between the business and Finance and other support functions (such as Legal, for example) about the effects of the new rules are essential. This rule change can't be left in an accounting silo.

If you're a business leader in an area where contracts for revenue are in place – such as Sales – you need to be speaking to the Finance team today to determine what the changes mean for your business.

Communication is critical because the new standard is so complex and its impacts are so pervasive that no one part of the business can understand all of the implications. The Finance team can't understand the full effects because they don't know the contracts that are in place well enough. The business can't understand the full effects because it doesn't know the accounting well enough.

Use these 10 key questions for your discussion with Finance.

Workshop it

My recommendation is to call for a workshop that gathers together the Finance team and representatives from other areas like Legal, Marketing or Sales who hold relevant knowledge about the contracts. Bring along details of your major contracts for revenue. Work through them and analyse how they will be affected by the new standard. Consider getting an external expert involved to facilitate the workshop – someone who knows the transition issues inside out and can help you focus on the key issues.

The workshop will also highlight the impacts you need to consider on core business systems and processes, including IT. These could be significant!

Be commercial

Running such a workshop might show that changes to the terms of some contracts with customers should be considered. It will help you identify what levers could be pulled to adjust your revenue profile so that it still works under the new standard.

You may also find suppliers approach *you* asking to change terms – understanding the standard means that you'll appreciate *why* they want to make the change. You may then be able to negotiate some concessions for yourself as a quid pro quo.

A second workshop with Procurement to consider contracts with suppliers may also therefore be a sensible move.

Leases too

"Summer's lease hath all too short a date," Shakespeare wrote. Well, the new leases standard has a longer lead time than revenue, coming into effect a year later, but it will also have major impacts and you need to start planning ahead for it now, given that leases are often long-term arrangements that can't easily be changed.

All in all, there is a lot to be done – so time is of the essence.

About the author

Reinhard leads a team of technical accounting specialists which supports clients in their IFRS conversion projects and provides accounting advice to companies in Singapore.

IFRS 15 - 10 questions for business unit heads

These questions will help business unit heads focus their consideration of the impact of IFRS 15 on their business

1. How does my revenue change for my **key types of contract**?
2. What are the **key drivers** for that change – e.g. legal terms, rebate schemes and milestone definitions?
3. What alternatives do I have to **change contract terms** to maintain the revenue profile – e.g. introducing enforceable right to payment clauses?
4. Will these changes be pervasive and therefore **change common market terms and conditions** for my business?
5. If the market is going to change, how can I create a **competitive advantage** when dealing with the changes?

6. What changes are therefore necessary to my **business processes, procedures and controls**?
7. Will the IFRS 15 numbers form an appropriate basis for management reward or do I need to **maintain management reporting on a different basis** internally?
8. How does this change interact with the **upcoming changes to lease accounting**?
9. What concessions could I request to gain **competitive advantage in procurement** when re-negotiating contracts with suppliers (given that my costs represent their revenue)?
10. What is the **best way forward** to deal with the questions above and **who should help me** with this work stream – e.g. Finance, Legal, Operations or external experts?